

Report  
of the  
Examination of  
Racine County Mutual Insurance Company  
Franksville, Wisconsin  
As of December 31, 2004

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

**Jim Doyle**, Governor  
**Jorge Gomez**, Commissioner

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September 22, 2005

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Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of  
December 31, 2004, of the affairs and financial condition of:

RACINE COUNTY MUTUAL INSURANCE COMPANY  
Franksville, Wisconsin 53126

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The previous examination of Racine County Mutual Insurance Company (the company) was made in 2000 as of December 31, 1999. The current examination covered the intervening time period ending December 31, 2004, and included a review of such subsequent transactions deemed essential to complete this examination.

The "Summary of Examination Results" contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was organized as a town mutual insurance company on January 1, 1873, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Raymond Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were two amendments to the articles of incorporation and no amendments to the bylaws. In April 2001, Article III of the articles of incorporation was changed to reduce the number of directors needed to manage the company from seven members to between five and seven members. Article III was also changed at that time to reduce the number of licensed agent/brokers that can serve on the board of directors of the company from three to two.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. The company is currently licensed to write business in the following counties:

Kenosha	Walworth
Milwaukee	Washington
Ozaukee	Waukesha
Racine	

A review was made of the policy and application forms currently used by the company. The company issues approved policies with or without endorsements for terms of one year with premiums payable on the advance premium basis. The company does not charge any other fees to policyholders.

Business of the company is acquired through 36 agents, which write business for 10 different agencies. One of the agents is a director of the company. Agents are presently compensated for their services as follows:

<b>Type of Policy</b>	<b>Compensation</b>
New and Renewal Business	15%

Only the two agents who are employees of the company have the authority to adjust small losses. Losses over \$3,000 are handled by outside adjusting companies.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

## Board of Directors

The board of directors currently consists of six members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Randy Peterka	Farmer	Caledonia, WI	2006
James R. Holding	Farmer	Franksville, WI	2007
Lee Fuhrman*	Insurance Agent; General Manager and Secretary	Racine, WI	2008
Gilbert Hagemann	Farmer	Franksville, WI	2008
Robert Grove	Farmer	Caledonia, WI	2006
Barbara Welch	Real Estate Agent	Caledonia, WI	2007

\* Directors who are also agents are identified with an asterisk.

Members of the board currently receive \$75.00 for each meeting attended, \$125.00 for all-day meetings, and \$.405 per mile for travel expenses.

## Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2004 Salary
Randy Peterka	President	\$ 2,000
James Holding	Vice President	250
Lee Fuhrman	Secretary/General Manager	40,000
Randy Peterka	Treasurer	4,000

The Secretary/General Manager also receives commissions as an agent. As of December 2004, Mr. Fuhrman owned both Fuhrman Insurance Unlimited and the Carls Agency, which accounted for 78% of commissions paid in 2004 or \$73,013. Mr. Fuhrman also writes business for Racine County Mutual Agency, which was established in 1995 as an administrative entity to write business for the company after an agent was cancelled. The Racine County Mutual Agency accounted for \$12,502 of commissions paid in 2004 or 13%; however, the general

manager and office assistant who both write business for this agency are paid a salary for duties performed and commissions are paid directly to the company.

### **Committees of the Board**

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

#### **Executive Committee**

Randy Peterka  
Lee Fuhrman  
James Holding

#### **Underwriting Committee**

Randy Peterka  
Lee Fuhrman  
Barbara Welch

#### **Inspection Committee**

Gilbert Hagemann  
Lee Fuhrman  
Robert Grove

#### **Claims Committee**

Gilbert Hagemann  
James Holding  
Robert Grove

### **Growth of Company**

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

<b>Year</b>	<b>Net Premiums Earned</b>	<b>Policies In Force</b>	<b>Net Income</b>	<b>Admitted Assets</b>	<b>Policyholders' Surplus</b>
2004	\$385,894	928	\$(34,150)	\$2,092,792	\$1,742,248
2003	284,468	907	11,336	2,045,552	1,714,554
2002	222,448	770	60,486	1,978,612	1,705,477
2001	206,294	710	69,597	1,891,685	1,672,285
2000	195,508	695	(3,464)	1,835,010	1,613,221
1999	223,785	703	44,619	1,724,211	1,589,680

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

<b>Year</b>	<b>Gross Premiums Written</b>	<b>Net Premiums Written</b>	<b>Ending Surplus</b>	<b>Writings Ratios Net</b>	<b>Gross</b>
2004	\$613,758	\$436,729	\$1,742,248	25%	35%
2003	545,063	317,873	1,714,554	19	32
2002	464,950	251,389	1,705,477	15	27
2001	395,031	218,246	1,672,285	13	24
2000	372,792	204,862	1,613,221	13	23
1999	380,924	226,856	1,589,680	14	24

For the same period, the company's operating ratios were as follows:

<b>Year</b>	<b>Net Losses and LAE Incurred</b>	<b>Other Underwriting Expenses Incurred</b>	<b>Net Earned Premiums</b>	<b>Loss Ratio</b>	<b>Expense Ratio</b>	<b>Com- posite Ratio</b>
2004	\$272,968	\$227,192	\$385,894	71%	52%	123%
2003	165,779	182,058	284,468	58	57	116
2002	68,104	161,344	222,448	31	64	95
2001	68,469	145,503	206,294	33	67	100
2000	146,314	146,669	195,508	75	72	146
1999	92,009	159,715	223,785	41	70	112

The company produced a net income in three out of five years since the last exam. Over the past five years, surplus has increased 9.5% from \$1,589,680 in 1999 to \$1,742,248 in 2004. Admitted assets showed a 21.4% increase over the same period. After declining in 2000, net premiums written have increased each year for a 92.5% increase over the five-year period, while policies in-force increased 32% since the prior exam. The company's expense ratio has decreased from 72% to 52% over the past five years, but it still continues to be high when compared to other town mutual insurers whose expense ratios average in the low 40% range. The company's composite ratio has fluctuated over the five-year period, but was over 100% in three of the five years.

## II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there currently is one ceding treaty and no assuming treaties. All treaties reviewed contained proper insolvency clauses. All treaties complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective Date:	January 1, 2005
Termination provisions:	Either party may terminate the contract as of January 1, 2006, or any subsequent January 1, by giving to the other party at least 90 days' advance notice in writing.
1. Type of contract:	Class A Excess of Loss Reinsurance
Lines reinsured:	All liability (nonproperty) business
Company's retention:	\$750 for each and every loss occurrence. The reinsurer may permit the company to adjust property damage losses that fall within the company's net loss retention.
Coverage:	Loss and loss adjustment expense in excess of the company's retention up to the following maximum policy limits:  \$1,000,000 – per occurrence, single limit, combined for bodily injury and property damage liability. \$1,000,000 – split limits, in any combination of bodily injury and property damage liability. \$5,000 – for medical payments, per person; \$25,000 per accident.
Reinsurance premium:	75% of the premium written for each and every policy of the business covered.
2. Type of contract:	Class B First Surplus Reinsurance
Lines reinsured:	Property
Company's retention:	When the company's net retention is \$300,000 or more, the company may cede on a pro rata basis up to \$800,000. When the net retention is \$300,000 or less, the company may cede up to 50% of such risk.
Coverage:	Pro rata share of each and every loss, including loss adjustment expense, corresponding to the amount of the risk ceded.
Reinsurance premium:	Pro rata of all premiums, fees and assessments corresponding to each of the risk ceded.



Ceding commission:	Commission allowance: 15% of the premium paid Profit commission: 15% of the net profit
3. Type of contract:	Class C-1 First Layer Excess of Loss Reinsurance
Lines reinsured:	Property
Company's retention:	\$40,000 for each and every risk resulting from one loss occurrence.
Coverage:	100% of any loss, including loss adjustment expenses, in excess of \$40,000 up to a maximum of \$60,000 in respect to each and every loss occurrence.
Reinsurance premium:	The rate in effect shall be determined by taking the sum of the four years' losses incurred (paid plus outstanding) by the reinsurer divided by the total of the net premiums written for the same period, multiplied by the factor 100/80ths, subject to a maximum rate of 20.5% and a minimum rate of 7%.  The current effective rate is 7.00%. The current deposit premium is \$36,610, subject to a minimum premium of \$20,000.
4. Type of contract:	Class C-2 Second Layer Excess of Loss Reinsurance
Lines reinsured:	Property
Company's retention:	\$100,000 for each and every loss occurrence
Coverage:	100% of any loss, including loss adjustment expenses, in excess of \$100,000 for each and every risk resulting from one loss occurrence up to a maximum of \$200,000 in respect to each and every loss occurrence.
Reinsurance premium:	4.50% of the current net premiums written Deposit premium: \$23,535 Minimum premium: \$16,000
5. Type of contract:	Class D/E-1 First Aggregate Stop Loss Reinsurance
Lines reinsured:	Property and nonproperty
Company's retention:	Net losses, including loss adjustment expenses, up to 75% of the company's net premium written; subject to a minimum retention of \$300,000.
Coverage:	100% of annual aggregate losses, including loss adjustment expenses, exceeding 75% of net premium written and in excess of the company's retention.
Reinsurance premium:	The rate for each annual period shall be determined by taking the sum of the eight years' losses incurred by the reinsurer divided by the total of the net premiums written

for the same period multiplied by the factor of 100/80ths,  
subject to a maximum rate of 25% and a minimum rate of  
7%.

Current rate: 7.00%

Deposit premium: \$38,360

Minimum premium: \$30,000.

### **III. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2004, annual statement.

Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

**Racine County Mutual Insurance Company**  
**Statement of Assets and Liabilities**  
**As of December 31, 2004**

<b>Assets</b>	<b>Ledger</b>	<b>Nonledger</b>	<b>Not Admitted</b>	<b>Net Admitted</b>
Cash in company's office	\$ 44	\$	\$	\$ 44
Cash deposited in checking account	(9,952)			(9,952)
Cash deposited at interest	1,557,200			1,557,200
Bonds				
Stocks and mutual fund investments	453,395			453,395
Premiums, agents' balances and installments:				
In course of collection	9,753			9,753
Deferred and not yet due	56,833			56,833
Investment income accrued		16,650		16,650
Assessments receivable				
Reinsurance premium recoverable	2,006			2,006
Other expense related assets:				
Reinsurance commission receivable	4,359			4,359
Other nonexpense related assets:				
Federal income tax recoverable	<u>2,504</u>	<u>          </u>	<u>          </u>	<u>2,504</u>
<b>Totals</b>	<b><u>\$2,076,142</u></b>	<b><u>\$16,650</u></b>	<b><u>\$ 0</u></b>	<b><u>\$2,092,792</u></b>

**Liabilities and Surplus**

Net unpaid losses	\$ 47,000
Unpaid loss adjustment expenses	2,300
Commissions payable	8,146
Fire department dues payable	547
Unearned premiums	279,010
Amounts withheld for the account of others	1,261
Other liabilities:	
Nonexpense related:	
Premiums received in advance	<u>12,280</u>
<b>Total Liabilities</b>	<b>350,544</b>
<b>Policyholders' surplus</b>	<b><u>1,742,248</u></b>
<b>Total Liabilities and Surplus</b>	<b><u>\$2,092,792</u></b>

**Racine County Mutual Insurance Company**  
**Statement of Operations**  
**For the Year 2004**

Net premiums and assessments earned		\$ 385,894
Deduct:		
Net losses incurred	\$212,913	
Net loss adjustment expenses incurred	60,649	
Other underwriting expenses incurred	<u>227,192</u>	
Total losses and expenses incurred		<u>500,160</u>
Net underwriting gain (loss)		(114,266)
Net investment income:		
Net investment income earned		67,080
Other income (expense):		
Miscellaneous income		<u>13,036</u>
Net income (loss) before federal income taxes		<u>(34,150)</u>
Net Income (Loss)		<u>\$ (34,150)</u>

**Racine County Mutual Insurance Company**  
**Reconciliation and Analysis of Surplus as Regards Policyholders**  
**For the Five-Year Period Ending December 31, 2004**

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
Surplus, beginning of year	\$1,714,554	\$1,705,477	\$1,672,285	\$1,613,221	\$1,589,680
Net income	(34,150)	11,336	60,486	69,597	(3,464)
Net unrealized capital gains or (losses)	61,844	(2,259)	(27,294)	(10,533)	26,773
Change in nonadmitted assets					<u>232</u>
Surplus, end of year	<u>\$1,742,248</u>	<u>\$1,714,554</u>	<u>\$1,705,477</u>	<u>\$1,672,285</u>	<u>\$1,613,221</u>

**Reconciliation of Policyholders' Surplus**

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' surplus per  
December 31, 2004, annual statement \$1,742,248

<b>Item</b>	<b>Increase</b>	<b>Decrease</b>	
Net Unpaid Losses	<u>\$</u>	<u>\$ 39,975</u>	
Total	<u>\$</u>	<u>\$ 39,975</u>	
Increase to Surplus per Examination			<u>39,975</u>
Policyholders' Surplus per Examination			<u>\$1,782,223</u>

#### IV. SUMMARY OF EXAMINATION RESULTS

##### Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Conflict of Interest—It is recommended that the company broaden its base of agents to avoid being dependent on only one agency.

Action—Partial compliance

2. Investments—It is recommended that the company prepare formal written bank reconciliations on a monthly basis, and maintain copies of the bank reconciliations along with the related bank statements.

Action—Partial compliance

3. Account and Records—It is recommended that the company take actions to remedy the deficiencies in its computer generated premium reporting system. Adjustments should be made to the reports before the final inclusion of balances in the annual statement.

Action—Compliance

## **Current Examination Results**

### **Corporate Records**

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with all of its agents and/or agencies, with the exception of its subsidiary, Racine County Mutual Agency. The contracts include language indicating the agent will represent the company's interests "in good faith." It is recommended that the company execute a formal written agency agreement with Racine County Mutual Agency that includes language indicating that the agency will represent the company's interests "in good faith."

During the review of the minutes of the board of directors it was noted that the articles and bylaws of the company were amended in April 2001. This amendment reduced the number of licensed agent/brokers that can serve on the board of directors from three to two. In 2004, s. 612.13, Wis. Stat., was amended to add language on inside directors that states that if a town mutual has fewer than nine directors, no more than one director may be an employee or representative of the town mutual. The company appears to be in compliance with s. 612.13 (1m), Wis. Stat., at this time; however, the company's bylaws could allow for up to two licensed agent/brokers to serve as directors in the future. Therefore, it is recommended that the company revise their articles and bylaws to be in compliance with s. 612.13 (1m), Wis. Stat.

### **Conflict of Interest**

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a



procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with one apparent conflict being noted.

Three agencies produce 90% of the company's business. Two of the agencies, Fuhrman Insurance Unlimited and Carls Insurance Agency, are owned by the company's general manager and his family and account for 77% of the company's business. The company's general manager also writes new business under the third agency, Racine County Mutual Insurance Agency. According to the agency agreement, in the event of a sale of the agency or departure of the general manager/agent, the company has first rights to purchase the renewal business at mutually agreeable terms. If the agency and the company cannot agree on mutually agreeable terms, each shall appoint an arbitrator and the arbitrators shall appoint a third party to establish the value of the renewal business. In lieu of a purchase, the company may assign the agreement to a successor, or may enter into a new agency agreement with a successor.

During the examination, it was determined that the company has been pursuing new agents to write business for the company over the past five years, without much success. The company appointed five agencies in 2002, for a total of twelve new agents. It was found, however, that some of the agencies that have been appointed were terminated due to lack of production. It was noted that the agencies that were appointed starting in 2002 wrote 4.7% of the company's business in 2002, 7.0% of the business in 2003, and 8.6% of the business in 2004. It was also noted that as of January 1, 2005, the general manager has sold Fuhrman Insurance Unlimited to his son and has plans to sell Carls Insurance Agency to him in the near future. The company feels that the appointment of two new agencies, which include fifteen new agents, in 2005 should relieve or eliminate any possible questions of conflict of interest or the perception that this may be an exclusive agency agreement even though it is not identified in the contract. It is again recommended that the company broaden its base of agents to avoid being dependent on agencies owned by one individual.

During the review of the minutes of the board of directors, it was noted that the minutes did not identify when a director abstained from a vote where there was a conflict of interest. In these cases, the director was also an employee of the company and the resolution

being voted on was the employee's contract. Identifying when directors abstain from this and similar votes would add credibility to the company's claim that directors properly disclose and abstain from voting when there are conflicts of interest. It is recommended that directors with conflict of interest properly abstain from voting on matters affecting their interest and that the minutes clearly indicate such.

### **Fidelity Bond and Other Insurance**

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

<b>Type of Coverage</b>	<b>Coverage Limits</b>
Fidelity bond	\$ 100,000
Worker's compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Commercial property:	
Building	150,000
Personal property	35,000
Commercial general liability:	
General aggregate	1,000,000
Products-completed operations	1,000,000
Personal and advertising injury	1,000,000
Each occurrence	1,000,000
Damage to premises rented	100,000
Medical expense	5,000
Commercial inland marine:	
Papers and records	25,000
Commercial auto:	
Bodily injury liability	1,000,000
Property damage liability	1,000,000
Combined professional and D&O liability	2,000,000

### **Underwriting**

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review.

During the review of the company's agent listing it was noted that the company failed to notify this office of the termination of appointment of three agents, in accordance with s. Ins 6.57 (2), Wis. Adm. Code. It is recommended that the company timely submit termination of agent appointments with the Office of the Commissioner of Insurance in accordance with s. Ins 6.57 (2), Wis. Adm. Code.

### **Claims Adjusting**

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

### **Accounts and Records**

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained.
2. A proper cash receipts journal is maintained.
3. A proper cash disbursements journal is maintained.
4. A proper general journal is maintained.
5. A proper general ledger is maintained.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2004.

The company is audited annually by an outside public accounting firm.

## **EDP Environment**

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computers is limited to people authorized to use the computers.

Company personnel back up the computers weekly and the backed-up data is kept on-site in a fireproof vault. An additional backup is made weekly and is kept off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

## **Business Continuity Plan**

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has not developed a business continuity plan. It is recommended that the company develop, and the board of directors approve, a comprehensive business continuity plan that would clearly identify what would be done in cases where it is not able to access its computers, if the office building is destroyed, or key personnel are lost.

## **Invested Assets**

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a

safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

### **Investment Rule Compliance**

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$ 650,544
2. Liabilities plus 33% of gross premiums written	553,544
3. Liabilities plus 50% of net premiums written	568,909
4. Amount required (greater of 1, 2, or 3)	650,544
5. Amount of Type 1 investments as of 12/31/2004	<u>1,549,009</u>
6. Excess or (deficiency)	<u>\$ 898,465</u>

The company has sufficient Type 1 investments.

## **ASSETS**

### **Cash and Invested Cash**

**\$1,547,292**

The above asset is comprised of the following types of cash items:

Cash in company's office	\$ 44
Cash deposited in banks-checking accounts	(9,952)
Cash deposited in banks at interest	<u>1,557,200</u>
Total	<u><b>\$1,547,292</b></u>

Cash in company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

During the examination, it was noted that when the company receives checks that are not deposited at the end of the day, the checks are stored in the office desk overnight. It is suggested that the company lock up checks not being deposited at the end of the day in the vault for safekeeping.

As a result of the prior examination, it was recommended that the company prepare formal written bank reconciliations on a monthly basis and maintain copies of the bank reconciliations along with the related bank statements. During this examination, a review of the company's checking account indicated that the company has changed its reconciliation procedures, which includes creating a list of checks outstanding at month-end, but the company still does not prepare a formal written bank reconciliation. Therefore, it is again recommended that the company prepare formal written bank reconciliations on a monthly basis and maintain copies of the bank reconciliations along with the related bank statements.

Cash deposited in banks represents the aggregate of 16 deposits in 16 different depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during

the year 2004 totaled \$57,841 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 2.96% to 6.90%. Accrued interest on cash deposits totaled \$16,650 at year-end.

**Stocks and Mutual Fund Investments**

**\$453,395**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2004. Stocks owned by the company are located in the company's safety deposit box.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2004 on stocks and mutual funds amounted to \$13,721 and were traced to cash receipts records. There were no accrued dividends at December 31, 2004.

**Premiums, Agents' Balances in Course of Collection**

**\$9,753**

This asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of detailed premium records verified the accuracy of this asset.

**Premiums Deferred and Not Yet Due**

**\$56,833**

This asset represents modal premium installments (such as monthly, quarterly, etc.) that are not yet due. A review of a sample from the company's detailed list of deferred premiums, verified the accuracy of this asset.

**Investment Income Accrued**

**\$16,650**

Interest due and accrued on the various assets of the company at December 31, 2004, consists of the following:

Cash at Interest	<u>\$16,650</u>
Total	<u>\$16,650</u>

**Reinsurance Premium Recoverable** **\$2,006**

The asset represents the amount of reinsurance premium that the company had overpaid as of December 31, 2004. The examiners verified the balance directly with the reinsurer.

**Reinsurance Commission Receivable** **\$4,359**

The above asset represents the amount of reinsurance commissions that the company expected to receive as of December 31, 2004, based on the profitability of the business ceded under its contract with Wisconsin Reinsurance Corporation. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

**Federal Income Tax Refund Receivable** **\$2,504**

This asset represents the overpayment of federal income taxes. The examiner reviewed the federal income tax return and found this asset to be correctly stated.



## LIABILITIES AND SURPLUS

### Net Unpaid Losses

**\$47,000**

This liability represents losses incurred on or prior to December 31, 2004, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2004, with incurred dates in 2004 and prior years. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule:

	<b>Company Estimate</b>	<b>Examiners' Development</b>	<b>Difference</b>
Incurred but unpaid losses	\$69,000	\$7,025	\$61,975
Less: Reinsurance recoverable on unpaid losses	<u>22,000</u>	<u>      </u>	<u>22,000</u>
Net Unpaid Losses	<u>\$47,000</u>	<u>\$7,025</u>	<u>\$39,975</u>

The net difference is reflected in Section III of this report under the heading, Reconciliation of Policyholders' Surplus.

The company indicated that a large hailstorm hit their region on May 20, 2004, which led to a majority of the claims filed by policyholders in 2004. Many of the claims related to the hailstorm were left open at year-end in order to cover any receipts that the policyholders may present to the company related to repairs that were completed in early 2005. It was noted during the examination that the company had closed all open claims by the end of March 2005 without further payment on most of the claims. This practice led to the net difference in unpaid losses.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss.

In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

**Unpaid Loss Adjustment Expenses****\$2,300**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2004, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is an estimate made by management as of year-end. The amount for unpaid loss adjustment expense is adjusted monthly according to loss development trends.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses determined this liability to be adequately stated.

**Commissions Payable****\$8,146**

This liability represents the commissions payable to agents as of December 31, 2004. The examiners reviewed the company's commission calculation and found the liability to be reasonably stated.

**Fire Department Dues Payable****\$547**

This liability represents the fire department dues payable to the State of Wisconsin as of December 31, 2004.

The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

**Unearned Premiums****\$279,010**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

**Amounts Withheld for the Account of Others****\$1,261**

This liability represents employee payroll deductions in the possession of the company at December 31, 2004. Supporting records and subsequent cash disbursements verified this item.

**Premiums Received in Advance****\$12,280**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2004. The examiners reviewed 2004 premium and cash receipt records to verify the accuracy of this liability.

## **V. CONCLUSION**

A total of seven recommendations and one suggestion were made and there was one adjustment to surplus increasing it by \$39,975. Two of the recommendations were repeat recommendations from the prior examination. The recommendations relate to a variety of record keeping and reporting requirements of the company. The comments and recommendations have been summarized in the subsequent section. The adjustment to surplus was made to correct the company's year-end unpaid loss reserves.

The company's surplus per examination of \$1,782,223 represents a 12% increase over the past five years. The company reported assets of \$2,092,792 and liabilities of \$350,544, which are all-time high levels for the company. Net premiums written have increased 92.5% to \$436,729 over the previous five years.

The company has appointed seven new agencies over the past five years, five in 2002 and two in 2005, for a total of twenty-seven new agents. The appointment of these new agencies, however, has not changed the percentage of business produced by the company's agencies significantly. The five agencies appointed in 2002 have contributed 4.7% of business written in 2002, 7.0% of business written in 2003, and 8.6% of business written in 2004. The company continues to have 90% of its business produced by three agencies, of which two are owned by the company's general manager and his family and the third is the company's in-house agency operated by the general manager. The company plans to continue to seek agents who will have a positive impact on business. The company feels that this practice, along with the general manager's sale of Fuhrman Insurance Unlimited and the Carls Insurance Agency to his son, should reduce any questions of conflict of interest related to the company; however, the examiners point out that the company will remain reliant on two agencies owned by one individual that produce almost 80% of its business.

## VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Corporate Records—It is recommended that the company execute a formal written agency agreement with Racine County Mutual Agency that includes language indicating that the agency will represent the company's interests "in good faith."
2. Page 14 - Corporate Records—It is recommended that the company revise their articles and bylaws to be in compliance with s. 612.13 (1m), Wis. Stat.
3. Page 15 - Conflict of Interest—It is again recommended that the company broaden its base of agents to avoid being dependent on agencies owned by one individual.
4. Page 16 - Conflict of Interest—It is recommended that directors with conflict of interest properly abstain from voting on matters affecting their interest and that the minutes clearly indicate it.
5. Page 17 - Underwriting—It is recommended that the company timely submit termination of agent appointments with the Office of the Commissioner of Insurance in accordance with s. Ins 6.57 (2), Wis. Adm. Code.
6. Page 18 - Business Continuity Plan—It is recommended that the company develop, and the board of directors approve, a comprehensive business continuity plan that would clearly identify what would be done in cases where it is not able to access its computers, if the office building is destroyed, or key personnel are lost.
7. Page 20 - Cash and Invested Cash—It is suggested that the company lock up checks not being deposited at the end of the day in the vault for safekeeping.
8. Page 20 - Cash and Invested Cash—It is again recommended that the company prepare formal written bank reconciliations on a monthly basis and maintain copies of the bank reconciliation along with the related bank statements.

## **VII. ACKNOWLEDGMENT**

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Stephen Elmer of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Angela J. Graff  
Examiner-in-Charge